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SUBJECT: NEPAL: COST OF THE MAOIST INSURGENCY

REF: 04 KATHMANDU 002367

SUMMARY

1. The effect of the ongoing Maoist insurgency is palpable in every sector of Nepal's economy. The estimated economic cost of the conflict, since 1996 when it started, is more than USD 2.3 billion. Insurgents have destroyed public and private property worth USD 71 million. The conflict has reduced the flow of foreign direct investment (FDI) to its lowest figure in 10 years. Recent Maoist bombings and forced closures of schools and industries have put the lives of thousands of workers and students in jeopardy. END SUMMARY.

COSTS OF THE MAOIST CONFLICT

2. The estimated economic cost of the conflict is more than USD 2.3 billion. Although the Maoist insurgency started in 1996, it escalated and began to seriously affect the economy in 2001, when the Maoists embarked on a strategy of armed attacks against security forces and government infrastructure. Maoist insurgents have systematically destroyed power installations, telecommunications facilities, bridges, government buildings and facilities, banks, schools, health posts, and hospitals. The resulting loss of physical infrastructure and property exceeds USD 71 million.

3. According to media reports and various domestic and international agencies, more than 12,000 people have lost their lives as a result of the conflict. According to the UNDP, more than 200,000 families have been internally displaced, and according to the Informal Sector Service Center (INSEC) more than 100,000 Nepalis have fled to India in search of employment, leaving behind vulnerable family members, including women, the elderly, and children. The insurgency has not only increased the cost of delivery of goods and services but has also contributed to an economic slowdown.

4. A comparison of national budget figures reveals that annual growth in total security spending averaged 21 percent between the years 2001 to 2005, compared to an average growth of 13.5 percent between 1996 and 2000. Total security spending more than doubled, from a total of USD 410 million for the years 1996 to 2000, to a total of USD 895 million for the years 2001 to 2005. The numbers demonstrate how the Maoist insurgency has increasingly strained Nepal's scarce national resources.

MASSIVE DECLINE IN GROSS DOMESTIC PRODUCT

5. According to calculations based on the projected annual growth rate of 5 percent set by the National Planning Commission, Nepal has lost more than USD 1.75 billion in GDP during nine years of insurgency, which is more than 40 percent of Nepal's estimated real GDP of USD 4.2 billion in FY 2004/05. Violence and destruction carried out by Maoist insurgents have caused Nepal's economic growth to dwindle to an average of 2.02 percent in the period between FY 2001/02 and FY 2004/05. The escalating armed conflict, coupled with industrial closures, transport blockades, abductions, killings, extortion, and internal and external displacement of large numbers of people, has crippled Nepal's economic growth rate. According to the Economic Survey Report released by the Ministry of Finance on July 15, 2005, Nepal's economic growth rate slid to a meager 2 percent in FY 04/05. The GDP growth rate during the first five years of the Maoist insurgency, from 1996 to 2000, averaged 4.8 percent; when the insurgency turned violent, from 2001 to 2005, the growth rate plummeted to 2 percent.

DESTRUCTION OF PHYSICAL INFRASTRUCTURE

6. Maoists have destroyed government and private property worth millions of dollars since 1996. In their continued attacks on remote district headquarters starting in November 2001, the Maoists have destroyed government buildings, bridges, telephone facilities, electricity sub-stations, schools, health posts, banks, and private homes. Although it is difficult to determine the exact extent of loss in dollar terms, based on the information provided by government agencies, newspaper reports, and independent analysis, the loss ranges between USD 70 and 80 million. However, there is no central agency of HMGN which keeps records of destruction and physical property damage done by the Maoists.

7. The following figures illustrate the cost of destruction to property:

-- Home Ministry infrastructure: USD 7.31 million

-- Civil Police & Armed Police property: USD 4.21 million
-- Telecommunications, radio and television facilities: USD 10.12 million
-- Government local development facilities: USD 6.42 million
-- Forest & Soil Conservation Ministry facilities: USD 4.4 million
-- Airports: USD 1.94 million
-- Electricity facilities: USD 2.23 million
-- Roads, bridges, buildings and equipment: USD 0.76
-- Postal service facilities: USD 0.47
-- Government banks and financial institutions: USD 4.35 million
-- Other government facilities: USD 2.08 million
-- Commercial banks (including property lost and cash looted): USD 2.8 million
-- Private property: USD 8.20 million
-- Compensation to deceased police and civilians, families: USD 13.41 million

SIGNIFICANT DROP IN FOREIGN DIRECT INVESTMENT (FDI)

18. The insurgency has severely affected the flow of Foreign Direct Investment (FDI) into Nepal. The escalating armed conflict, coupled with insecurity and widespread Maoist extortion, has caused significant loss of confidence in the investment climate, and as a result FDI commitments decreased substantially. The worsening security situation, coupled with Nepal's poor infrastructure and regulatory regime, reduced the flow of FDI to USD 12.2 million in FY 2004/05, the lowest figure in the last 10 years. Nepal received foreign investment commitments worth USD 156 million between 1996 and 2000, the first five years of the Maoist insurgency, but between 2001 and 2005, Nepal received FDI commitments totaling only USD 130 million. During the reform period between 1992 and 1993, the inflow of FDI to Nepal had reached USD 63 million.

SECTOR STUDIES

1A. Massive Destruction of Industries:

19. The industrial sector has borne the real brunt of the Maoist insurgency. The bombing of Nepal's two largest spinning mills in July and August caused combined damage worth roughly USD 7 million, and rendered more than 3,500 workers jobless. Beleaguered by the Maoists frequent threats, Colgate Palmolive reduced its operations by seventy percent in July. Unilever Nepal, which provides direct employment to 135 people, shut down its plant for two weeks in August due to Maoist threats. In December 2004, Indian Hotels Company Ltd. (IHCL), the owner of the Taj hotel chain in India, pulled out of a contract with a five-star hotel in Kathmandu, citing security concerns. Madhav Adhikari, President of Hetauda Chamber of Commerce and Industry, told EmbOff, "if the present turmoil in industries continues, other foreign investment industries will also relocate to India."

110. In July 2005, the All Nepal Trade Union Federation Revolutionary (ANTUF-R), the Maoist-affiliated trade union, called for the indefinite closure of all tea estates in eastern Nepal. The closure, announced on July 16, caused a daily loss of USD 285,000. According to the National Tea and Coffee Development Board (NTCDB), more than 40,000 workers, 6,252 small farmers and about 100 large business firms involved in the tea industry were directly affected by the three week closure. Wageworkers and small farmers, who were the worst hit, are the main stakeholders in Nepal tea industry.

1B. Education Sector in the Doldrums: A Caveat

111. Nepal's education sector has also borne the brunt of the Maoist insurgency. From the beginning of the insurgency, Maoists have made the education sector their main target, calling for frequent and prolonged academic closures and routinely abducting hundreds of students for what they call "indoctrination sessions." Most of the students are released after a few days of captivity, although some are recruited into the Maoist militia. Parents are moving increasing numbers of children to India for schooling due to the fear of Maoist abduction and continuous disruption of academic sessions.

112. Reports estimate that Maoists have abducted more than 25,000 students since 1996. According to a recent report released by the local NGO Informal Sector Service Center (INSEC), from January to August 2005 alone, Maoists abducted more than 3,000 students and 600 teachers from various parts of the country. According to the Economic Survey of Nepal released recently by the Ministry of Finance, 2,077 primary schools, 518 lower secondary schools, and 22 secondary schools have closed down since 2004 due to the escalating insurgency.

COMMENT

113. The Maoist insurgency has not only resulted in a near halt of Nepal's economy and development, it has also made the prospects of bringing the economic and developmental activities back on track extremely bleak.

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